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IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

NEWARK MORNING LEDGER COMPANY,
as successor to The Herald Company,

Petitioner,

—v.—

UNITED STATES OF AMERICA,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF OF WORRELL ENTERPRISES, INC. AS AMICUS CURIAE IN SUPPORT OF PETITIONER

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QUESTION PRESENTED

Whether the Third Circuit, in acknowledged conflict with other circuits and the United States Tax Court, was correct that under the Internal Revenue Code an income-producing wasting intangible asset may be nondepreciable "goodwill" as a matter of law.

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INTEREST OF AMICUS CURIAE

Worrell Enterprises, Inc. ("Worrell Enterprises") is a Delaware corporation with its principal place of business in Boca Raton, Florida. Worrell Enterprises currently owns and operates approximately 70 newspapers in 9 States across the United States, from New Jersey to Florida and from Florida to California. Worrell Enterprises and certain affiliated entities and related individuals (collectively the "Worrell group") are contesting, in one matter before the Internal Revenue Service and in a second matter in the United States District Court for the Southern District of Florida, the amortization of newspaper subscriber relationships acquired by the Worrell group when it acquired, along with the other assets, several of its newspaper publishing companies.

The decision of the Third Circuit Court of Appeals in the case with respect to which this brief is being filed, if permitted to stand, may adversely affect not only the matters being contested by the Worrell group but also the Worrell group's tax liabilities in future years. The Third Circuit's decision is fundamentally inconsistent with nearly two decades of settled legal authority. The Worrell group believes that its views, business practices and settled business expectations will be of assistance to the Court in determining that the issue of whether newspaper subscriber relationships are amortizable for tax purposes is, contrary to the conclusion of the Third Circuit, an issue of fact rather than a matter of law, or if it is determined to be a matter of law, that newspaper subscriber relationships are clearly amortizable.

Counsel for both parties have consented to our appearance as amicus curiae. Their written consents are filed together with this brief.

SUMMARY OF THE ARGUMENT

The Worrell group has, for nearly two decades, determined the purchase price of newspapers that it acquired by relying on (1) the economically demonstrable fact that newspaper subscriber relationships have both a determinable and limited useful life, the duration of which can be ascertained with reasonable accuracy, and an ascertainable value separate and distinct from goodwill that can be determined by using standard valuation techniques and generally accepted accounting methods, and (2) the law as reflected in the Internal Revenue Service's own published 1974 revenue ruling and in many cases since 1973 (for example, *Houston Chronicle Publishing Co. v. United States*, 481 F.2d 1240 (5th Cir. 1973), *cert. denied*, 414 U.S. 1129 (1974); *Donrey, Inc. v. United States*, 809 F.2d 534 (8th Cir. 1987)) that the taxpayer can, as a matter of fact and by satisfying its burden of proof, demonstrate that its subscriber relationships are amortizable for income tax purposes.

ARGUMENT

1. In reliance on Rev. Rul. 74-456, in which the Internal Revenue Service recognized that the amortizability of newspaper subscriber relationships is a question of fact rather than a matter of law, the Worrell group has evaluated more than 100 potential acquisitions and has priced and acquired more than 40 newspapers.

In 1974, the Internal Revenue Service published Rev. Rul. 74-456, 1974-2 C.B. 65, modifying two 1965 revenue rulings and interpreting section 1.167(a)-3 of the Income Tax Regulations:

> *to remove any implication* that . . . subscription lists . . . are, as a matter of law, indistinguishable from goodwill possessing no determinable useful life. The depreciability of assets of this nature is a factual question, the determination of which rests on whether the taxpayer establishes that the assets (1) have an ascertainable value separate and distinct from goodwill, and (2) have a limited useful life, the duration of which can be ascertained with reasonable accuracy. *Id.* at 66. (Emphasis added.)

During the 18 years since the publication of Rev. Rul. 74-456, *supra*, the Worrell group has evaluated more than 100 potential newspaper acquisitions and has acquired more than 40 newspapers. While there are many elements in the evaluation process when a newspaper is being purchased, the key element in pricing a newspaper, in reliance on Rev. Rul. 74-456, *supra*, and the long-standing policy of the Internal Revenue Service, is the analysis of existing subscribers.

Subscriber analysis is critical for the following reasons:

A comparison of paid subscribers to the population of the area demonstrates market penetration and, hence, the newspaper's potential share of the total market's advertising revenues. Subscriber analysis also develops an advertising rate range, the potential or correct amount a newspaper should

charge its advertisers. Advertising revenues represent more than 75% of the gross revenues of the Worrell group's newspapers, and the subscriber list is, in each case, the "machine" that generates those advertising revenues.

The Worrell group, as a newspaper acquirer, must understand and demonstrate market penetration, because the key to selling advertising is for the advertiser to see definitive results from running an advertisement. Gauging market penetration and, more importantly, readership shows potential newspaper advertisers the effect of their advertisements as compared with other advertising media, such as radio, television, and other newspapers. A keen understanding of subscribers, including their income, education, literacy, mobility and age, provides the empirical data necessary to determine, with some precision, the newspaper's potential share of the advertising dollars spent in the market.

The final element of a subscriber list analysis involves a correlation of the to-be-acquired newspaper's particular subscribers with advertising rates, based upon the Worrell group's internally-generated correlation studies. In determining advertising rates, a newspaper must compare its individual and household coverage with the other advertising media in the same market. A newspaper has the ability to charge a premium compared with other forms of advertising because paid subscriptions provide a higher degree of certainty that the advertisement will be communicated to the potential buyer. While radio, television and billboard companies can generate statistical abstracts to estimate the number of people exposed to a particular advertisement, a newspaper enjoys a distinct advantage because, through audit procedures, there is absolute certainty that a specific number of individuals who have paid the subscription price will have received a copy of the advertisement.

In summary, the primary and long-standing principle of the Worrell group is to evaluate subscriber information in the process of making newspaper acquisitions. This methodology demonstrates the competitiveness of the market, the ability of

a newspaper to sell advertising, the rate at which advertising should be sold and, accordingly, the estimated gross revenues of the newspaper.

In contrast, when analyzing newspapers that do not have paid subscribers, the Worrell group focuses on advertiser relations and specific market niches. Those attributes of a free distribution newspaper are so nebulous that the purchase price paid to acquire it is seldom more than 20% of the price paid for a newspaper that is based on a paid subscriber network.

The main element in evaluating subscribers entails the determination of the estimated life of the subscriber group. In the mid-1970's, in the process of making an acquisition, the Worrell group's chief executive officer, chief financial officer and their staffs internally estimated the value of the target newspaper's subscriber relationships and, subsequent to the acquisition, retained an independent appraisal company to formalize the valuation process. Both the internal process and the formal appraisal entailed evaluating the age of the population, the different levels of standard of living, and the market migration rate. These factors produced an annual subscriber termination rate for the particular acquired newspaper. All newspapers lose subscribers from death, migration and cancellation. The standards of living of the various segments of the population provide keen insight into cancellation rates. Where standards of living are low on the average, the literacy level is also low and people are more likely to cancel because they lack the desire to read the newspaper. By contrast, in a market having an extremely high standard of living, cancellations may result from the political perspective of the newspaper.

This evaluation process evolved in the late 1970's and early 1980's so that subsequent acquisitions up to the present time by the Worrell group have entailed the following additional procedures:

1. Prior to negotiating the purchase price of a newspaper, demographic information is obtained in order that the Wor-

rell group can determine internally the life and value of the newspaper's subscribers.

2. In the purchase documents, the value of the subscribers is usually separately stated. In all cases, the sellers represent and warrant the number of paid subscribers.

3. Many acquisition agreements include a formula under which the purchase price is to be reduced if the actual number of subscribers, determined after the closing of the acquisition, is found to be less than the number represented by the sellers.

4. Prior to or simultaneously with the culmination of the acquisition, an appraisal company is retained to formalize the prior estimate of the life of the subscribers and to place a value on the subscription relationships as a separately negotiated for, and separately purchased, asset.

5. To ascertain the validity of the life methodology used, the Worrell group performs an additional analysis several years subsequent to the acquisition. The subscribers at the time of acquisition are compared with the then current subscribers. From this analysis, an exact exhaustion rate of the subscriber base can be obtained.

II. There are established appraisal and accounting methods for determining the useful life and value of newspaper subscriber relationships, and the Worrell group, as a matter of settled business expectations, has followed these methods since the 1970's in its acquisition of newspapers.

Determining the useful life of subscribers since the 1970's has been accomplished by the Worrell group through the use of some or all of the following techniques:

a. The Worrell group would obtain information as to the several years prior to the acquisition to determine, on a monthly basis, the numbers of new and cancelled subscribers. This information, used in conjunction with the number of subscribers at the beginning and at the end of the period,

produces a factor showing the decline of the subscriber base, if efforts are not undertaken to obtain new subscribers.

b. Telephone surveys would be utilized to determine migration and cancellation rates as well as the length of time that individuals have subscribed to the newspaper. Using the gross population, cancellation rates and death rates over a period of years can also produce the rate at which the number of subscribers will decline, if solicitation is not undertaken to acquire new subscribers.

c. The Audit Bureau of Circulation, the largest national independent auditing company on which newspapers, advertisers and advertising agencies rely, would furnish verified, accurate numbers of paid subscribers in specific newspaper market areas, and its data would be used to verify the figures furnished by the seller as well as the figures developed by the Worrell group.

d. The Worrell group would analyze many of the factors that enter into the determination of useful life, to the extent relevant to the particular acquisition, including market penetration (the ratio of paid subscribers to total market population); the number of subscribers; their distribution by age, education and standard of living; other economic and geographical factors; the number and type of competing newspapers as well as other media; the illiteracy rate; and the number of people who read each copy of the newspaper.

The number of subscribers dwindles as members of the original group of subscribers cancel, move or die. There is no "mass asset" that replenishes itself. Rather, great effort and expense must be expended to produce one new subscriber. Typically, as confirmed by readily-available industry-wide data, substantial expense and at least 25 new orders must be taken by an average newspaper in order to increase its circulation by one. Not only must substantial expense be incurred, but there is also a frequent need to change the content of a newspaper in order to attract younger readers or to broaden the geographical market area so as to increase the number of paid subscribers.

III. The Worrell group has relied on the 1974 Revenue Ruling, case authority, an extended Internal Revenue Service audit of the Worrell group's amortization practices, and the refusal by Congress in 1987 to prohibit the amortization of newspaper subscriber relationships. If amortization had been prohibited, the Worrell group would have purchased the acquired newspapers at a lower price or not at all.

The Worrell group has, for nearly two decades, determined the purchase prices for its acquisitions of other newspapers by valuing newspaper subscriber relationships pursuant to standard valuation techniques and generally accepted accounting methods. In doing so, the Worrell group has relied upon the law as reflected in the Internal Revenue Service's own published 1974 revenue ruling, as well as the many cases since 1973 holding that a taxpayer can, by satisfying its burden of proof, demonstrate that its subscriber relationships are amortizable for income tax purposes.

Amortization of several subscriber relationships relating to acquisitions of other newspapers by the Worrell group was expressly reaffirmed by the Internal Revenue Service in a field audit of the tax years ended February 1979 through February 1983. The Internal Revenue Service then submitted its audit conclusions to the Joint Committee on Taxation, which reviewed and approved the audit report. Thus, Internal Revenue Service conduct reaffirmed the approach of the Worrell group in determining how much to pay for a newspaper, how much of the purchase price to allocate to its subscriber relationships, and the useful life over which to amortize the subscriber relationships. Similarly, when Congress refused in 1987 to bar the amortization of subscriber relationships and other intangibles as a matter of law, the pricing methodology of the Worrell group in acquiring newspapers and amortizing the subscriber relationships for tax purposes was reaffirmed. See Section 10120 of H.R. 3545, the Revenue Bill of 1987, which was enacted (without Section 10120) as Title X of the Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, 101 Stat. 1330-1382 (1987).

CONCLUSION

Settled business expectations and established methods of valuing and acquiring newspapers over nearly two decades will be upset unless the Court decides that the amortization of newspaper subscriber relationships remains a question of fact under the Internal Revenue Code, or if amortization is held to be a matter of law, that newspaper subscriber relationships are clearly amortizable.

The decision of the Third Circuit should be reversed.

Respectfully submitted,

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